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SUBJECT: TAIWAN ENTREPRENEURS IN HANGZHOU CONCERNED ABOUT MAINLAND BUSINESS ENVIRONMENT

CLASSIFIED BY: Simon Schuchat, Deputy Principal Officer, U.S. Consulate General, Shanghai, Department of State.

REASON: 1.4 (b), (d)

¶11. (C) Summary: At an August 1 roundtable, members of the Hangzhou Taiwan Compatriots Investment Enterprise Association voiced concerns about the Mainland business environment, and wished for better access to national-level Chinese officials. Rising costs, a slowing global economy, the new Labor Contract Law, and changes in tax policy have all hurt their bottom line, and will lead to consolidation and some factory closures. Improvements in cross-Strait relations are welcome, but will not have a large impact on their businesses. End Summary.

¶12. (SBU) On August 1, DPO and Econoff met with eight entrepreneurs of the Hangzhou branch of the Taiwan Compatriots Investment Enterprise Association (Taixiehui), a trade association with branches in many major cities across China representing the interests of Taiwan companies operating in the Mainland. According to Jay Shane, Chairman of the Hangzhou Taixiehui, there are about 1000 Taiwan enterprises and 3000 to 4000 Taiwan persons living in Hangzhou. In Zhejiang Province (of which Hangzhou is the capital), there are 10,000 Taiwan companies, the majority located in Ningbo, Hangzhou, Jiaxing, Jiashan, and Wenzhou. In addition to his role as the Hangzhou Taixiehui Chairman, Shane is also Managing Director of a leather products company in Hangzhou. Representatives from a machine tools company, cleaning equipment company, aluminum company, food store chain, cosmetics company, and electronics firm also participated in the roundtable.

Looking for Channels of Influence

¶13. (C) Shane lamented that Taiwan businessmen have relatively weak channels of communication and influence with Chinese officialdom. At present, their interests are handled primarily by the State Council's Taiwan Affairs Office, an entity primarily interested in political issues and not attuned to Taiwan business interests. If Taiwan businessmen were represented in the National People's Congress, that would be much better. Shane complained that the NPC "Taiwan delegation" consists almost entirely of people born in the Mainland, who do not understand Taiwan. The delegation should be drawn from the Taiwan community currently residing in the Mainland -- a group of more than one million people, according to Shane. By

contrast, later in the meeting Shane boasted of his own relations with officials of Taiwan's ruling KMT party, noting that he had gone to Shanghai to meet with KMT Chairman Wu Po-Hsiung during his spring visit to the Mainland.

Business Sentiment Not Upbeat

¶4. (C) The Taiwan businessmen were not optimistic about the current and near term outlook for their businesses in the Mainland. According to Shane, Taiwan companies are concerned about the impact of Renminbi (RMB) appreciation on exports, reductions in value-added tax (VAT) rebates for exports, China's new Labor Contract Law, the rising cost of raw materials, and the loss of preferential tax treatment through tax unification. (Note: Until 2008, Taiwan companies enjoyed a preferential tax rate of 15 percent, compared with the 25 percent rate paid by all domestic and foreign firms. End note.) Shane was especially critical of the recently implemented labor law which, he says, has significantly increased costs, is heavily biased in favor of employees, and is a "time bomb" waiting to explode. All of these factors have adversely affected companies' bottom lines, leading to smaller profit margins and a "wash-out" period in which many Taiwan enterprises in Wenzhou, Dongguan (Guangdong Province), and other major export-oriented cities will probably close or consolidate.

¶5. (C) Alan Zhou, Director of the Mei Yuan Cosmetics Company, said his company faced financing difficulties due to the government's tight monetary policy. Likewise, Paul Chen, General Manager of the Hangzhou Good Friend Precision Machinery Company, a maker of machine tools, attributed his company's increasing financing costs to tightening monetary conditions.

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Since 60 percent of his exports go to the United States, the weak U.S. economy and depreciating U.S. dollar have also strained his business. Jian Mingkun, General Manager of the Hangzhou Jiamei Cleaning Equipment Company, complained that, due to the loss of preferential tax treatment, the tax rate in the Mainland is now higher than in Taiwan.

If We Can Only Survive the Next Few Years...

¶6. (C) However, not all our interlocutors were as downbeat. Gao Xinyi of the Xinyi Aluminum Company sees many of the recent moves by the Chinese Government as an effort to transition from low technology, labor-intensive industries to more high technology, higher value-added industries. The current round of industry consolidation will pose a challenge, but is a good opportunity for his company to win greater market share -- if it can survive the next few years. Similarly, Li Guoyan, Assistant to the Chairman of Cross Straits Cafe, a coffee shop and restaurant chain with 400 outlets throughout the Mainland, is fairly optimistic that industry consolidation would eliminate many competitors and benefit his company since it is already well established in the Mainland. His company has already received investment from Goldman Sachs and is planning an initial public offering (IPO) in China in 2010.

Improvements in Cross-Strait Relations Help, But...

¶7. (C) The Taiwan entrepreneurs welcomed improvements in cross-Strait relations following Ma Ying-jeou's election. Several participants said they had flown back to Taiwan to vote for Ma and are now relieved that the risk of a sudden flare-up across the Strait has diminished. However, they do not see a direct correlation between improved political relations and improved business conditions in the Mainland. The global economic downturn, particularly in the United States, and domestic Chinese labor, finance, and tax policy developments have outweighed the positives of improved cross-Strait relations.

¶8. (C) Shane said direct flights between Taiwan and the Mainland are convenient but would not have a huge impact on his business. He noted that direct flights between Taipei and

Hangzhou will commence later this year. Another participant mentioned that he still flies to Taiwan via Hong Kong since those routes are cheaper than direct flights and argued, to the approval of other participants, that ticket prices would need to come down, if direct flights are to be meaningful for cross-Straits businesses.

Nowhere Else to Go?

¶9. (C) Despite deteriorating business conditions in the Mainland, our interlocutors said they do not now plan to move elsewhere. When asked about the possibility of moving to Vietnam, several stated that this was not a good option, since Vietnam has a relatively small population and a limited pool of skilled labor. Furthermore, one observed, the workers there frequently go on strikes. Moving to China's interior provinces -- the Chinese Government's preferred option -- is also not so desirable due to high transportation costs, lower workforce productivity, and lack of adequate infrastructure. They estimate the total cost of operating in the interior provinces would be higher than operating in the coastal region. Furthermore, conditions in the interior resemble those they faced when they first came to the Mainland in the early 1990s. Several joked that they would not go through that hardship again.

Comment

¶10. (C) Although the Taiwan entrepreneurs are generally frustrated with current business conditions in the Mainland, their concerns are not unique to Taiwan firms. Other foreign and domestic firms have similar complaints about current business conditions. However, sentiments differ across industry lines. Entrepreneurs from export-oriented firms are more negative, since the global economic downturn, exchange rate developments, and recent policy changes such as the labor law, disproportionately affect lower value-added, labor-intensive,

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export-oriented enterprises. Those in the service or high-tech sectors are less anxious.

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